Attachment 14

2013 First Quarter Financial Statement for CHI

Catholic Health Initiatives

Consolidated Interim Financial Statements (Unaudited)
As of September 30, 2012 and for the Three Months Ended
September 30, 2012 and 2011

Catholic Health Initiatives
Consolidated Interim Financial Statements (Unaudited)

Contents

Consolidated Interim Financial Statements

Catholic Health Initiatives
Consolidated Balance Sheets
(In Thousands)

	September 30, 2012 *(Unaudited)*	June 30, 2012
Assets		
Current assets:		
Cash and equivalents	**$ 260,267**	$ 403,972
Net patient accounts receivable, less allowances of $733,644 at September and $687,631 at June, respectively	**1,385,314**	1,353,928
Other accounts receivable	**159,346**	116,607
Current portion of investments and assets limited as to use	**4,310**	1,901
Inventories	**186,415**	185,571
Assets held for sale	**476,961**	474,990
Prepaid and other	**109,921**	87,179
Total current assets	**2,582,534**	2,624,148
Investments and assets limited as to use:		
Internally designated for capital and other funds	**4,674,937**	4,588,519
Mission and Ministry Fund	**116,845**	110,918
Capital Resource Pool	**349,566**	320,218
Held by trustees	**228**	228
Held for insurance purposes	**765,621**	745,127
Restricted by donors	**171,532**	171,123
Total investments and assets limited as to use	**6,078,729**	5,936,133
Property and equipment, net	**5,374,752**	5,347,475
Deferred financing costs	**27,895**	28,717
Investments in unconsolidated organizations	**320,192**	307,918
Intangible assets and goodwill, net	**161,638**	162,880
Notes receivable and other	**604,028**	605,113
Total assets	**$ 15,149,768**	$ 15,012,384

Continued on following page

Catholic Health Initiatives
Consolidated Balance Sheets (continued)
(In Thousands)

	September 30, 2012 (Unaudited)	June 30, 2012
Liabilities and net assets		
Current liabilities:		
Compensation and benefits	$ **419,254**	$ 418,597
Third-party liabilities	**77,350**	76,660
Accounts payable and accrued expenses	**630,080**	718,897
Liabilities held for sale	**93,173**	103,633
Variable-rate debt with self liquidity	**321,455**	321,455
Commercial paper and current portion of debt	**643,599**	643,083
Total current liabilities	**2,184,911**	2,282,325
Pension liability	**899,976**	892,820
Self-insured reserves and claims	**517,371**	513,584
Other liabilities	**268,336**	236,763
Long-term debt	**3,755,280**	3,778,709
Total liabilities	**7,625,874**	7,704,201
Net assets:		
Net assets attributable to CHI	**7,135,214**	6,922,466
Net assets attributable to noncontrolling interests	**182,642**	180,863
Unrestricted	**7,317,856**	7,103,329
Temporarily restricted	**137,303**	136,821
Permanently restricted	**68,735**	68,033
Total net assets	**7,523,894**	7,308,183
Total liabilities and net assets	$ **15,149,768**	$ 15,012,384

See accompanying notes.

Catholic Health Initiatives
Consolidated Statements of Operations
(In Thousands)

	Three Months Ended September 30, 2012	2011
	(Unaudited)	
Revenues:		
Net patient services revenues before provision for doubtful accounts	$ **2,440,341**	$ 2,117,803
Provision for doubtful accounts	**(213,772)**	(182,203)
Net patient services revenues	**2,226,569**	1,935,600
Nonpatient:		
Donations	**13,738**	9,080
Changes in equity of unconsolidated organizations	**2,042**	4,430
Investment income used for operations	**33,243**	7,459
Other	**113,293**	106,058
Total nonpatient revenues	**162,316**	127,027
Total operating revenues	**2,388,885**	2,062,627
Expenses:		
Salaries and wages	**1,013,205**	867,610
Employee benefits	**221,457**	172,917
Purchased services, medical professional fees, consulting and legal	**241,242**	193,165
Supplies	**417,209**	359,562
Utilities	**34,558**	29,433
Rentals, leases, maintenance and insurance	**148,621**	119,563
Depreciation and amortization	**124,634**	108,794
Interest	**33,256**	31,237
Other	**143,377**	125,734
Total operating expenses before restructuring, impairment and other losses	**2,377,559**	2,008,015
Income from operations before restructuring, impairment and other losses	**11,326**	54,612
Restructuring, impairment and other losses	**11,870**	170
(Loss) income from operations	**(544)**	54,442
Nonoperating gains (losses):		
Investment income (losses), net	**204,826**	(421,600)
Realized and unrealized losses on interest rate swaps	**(4,923)**	(114,711)
Other nonoperating (losses)	**(1,768)**	(9,716)
Total nonoperating gains (losses)	**198,135**	(546,027)
Excess (deficit) of revenues over expenses	**197,591**	(491,585)
Excess of revenues over expenses attributable to noncontrolling interest	**1,665**	1,166
Excess (deficit) of revenues over expenses attributable to CHI	$ **195,926**	$ (492,751)

Catholic Health Initiatives
Consolidated Statements of Cash Flows
(In Thousands)

	Three Months Ended September 30, 2012	2011
	(Unaudited)	
Operating activities		
Increase (decrease) in net assets	$ **215,711**	$ (521,698)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	**124,634**	108,794
Provision for bad debts	**213,772**	182,203
Changes in equity of unconsolidated organizations	**(2,042)**	(4,430)
Net gains on sales of facilities and investments in unconsolidated organizations	**(6,490)**	(117)
(Increase) decrease in fair value of interest rate swaps	**(2,890)**	107,076
(Decrease) increase in unfunded pension liability	**(2,832)**	3,461
Net changes in current assets and liabilities:		
Net patient and other accounts receivable	**(295,408)**	(224,083)
Other current assets	**(24,380)**	(24,424)
Current liabilities	**(99,589)**	(86,781)
Other changes	**35,325**	(37,811)
Net cash provided by (used in) operating activities, before net change in investments and assets limited as to use	**155,811**	(497,810)
Net (increase) decrease in investments and assets limited as to use	**(144,563)**	558,971
Net cash provided by operating activities	**11,248**	61,161
Investing activities		
Purchases of property, equipment and other capital assets	**(155,031)**	(98,178)
Purchase of Nebraska Heart, net of cash acquired	–	(131,178)
Net cash proceeds from asset sales	**6,704**	16,096
Distributions from investments in unconsolidated organizations	**13,504**	6,962
Notes receivable from unconsolidated affiliates, net	**5,267**	1,693
Repayment of other notes receivable, net	**46**	6,134
Other changes	**(2,479)**	9,542
Net cash used in investing activities	**(131,989)**	(188,929)
Financing activities		
Repayment of debt	**(22,994)**	(37,248)
Proceeds from bank loans	**30**	1,900
Net cash used in financing activities	**(22,964)**	(35,348)
Decrease in cash and equivalents	**(143,705)**	(163,116)
Cash and equivalents at beginning of year	**403,972**	449,674
Cash and equivalents at end of year	$ **260,267**	$ 286,558

See accompanying notes.

Catholic Health Initiatives
Consolidated Statements of Changes in Net Assets
(In Thousands)

	Unrestricted Net Assets					
	Attributable to CHI	Attributable to Noncontrolling Interests	Total	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total Net Assets
Balances, June 30, 2011	$ 7,448,161	$ 8,967	$ 7,457,128	$ 122,795	$ 62,426	$ 7,642,349
Excess of revenues over expenses	94,929	537	95,466	–	–	95,466
Net loss from discontinued operations	(45,177)	–	(45,177)	–	–	(45,177)
Increase in pension liability	(618,141)	(878)	(619,019)	–	–	(619,019)
Temporarily and permanently restricted contributions	–	–	–	39,117	(122)	38,995
Net assets released from restriction for capital	18,119	–	18,119	(18,119)	–	–
Net assets released from restriction for operations	–	–	–	(19,689)	–	(19,689)
Investment income	232	–	232	1,007	47	1,286
KentuckyOne Health noncontrolling interest	–	181,551	181,551	–	–	181,551
Other changes in net assets	24,343	(9,314)	15,029	11,710	5,682	32,421
Net (decrease) increase in net assets	(525,695)	171,896	(353,799)	14,026	5,607	(334,166)
Balances, June 30, 2012	**6,922,466**	**180,863**	**7,103,329**	**136,821**	**68,033**	**7,308,183**
Excess of revenues over expenses	**195,926**	**1,665**	**197,591**	–	–	**197,591**
Net loss from discontinued operations	**1,258**	–	**1,258**	–	–	**1,258**
Increase in pension liability	**2,832**	–	**2,832**	–	–	**2,832**
Temporarily and permanently restricted contributions	–	–	–	**11,392**	**554**	**11,946**
Net assets released from restriction for capital	**3,176**	–	**3,176**	**(3,176)**	–	–
Net assets released from restriction for operations	–	–	–	**(9,599)**	–	**(9,599)**
Investment income	–	–	–	**1,760**	**258**	**2,018**
Other changes in net assets	**9,556**	**114**	**9,670**	**105**	**(110)**	**9,665**
Net increase in net assets	**212,748**	**1,779**	**214,527**	**482**	**702**	**215,711**
Balances, September 30, 2012 *(unaudited)*	**$ 7,135,214**	**$ 182,642**	**$ 7,317,856**	**$ 137,303**	**$ 68,735**	**$ 7,523,894**

See accompanying notes.

Catholic Health Initiatives
Notes to Consolidated Interim Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Organization

Catholic Health Initiatives (CHI), established in 1996, is a tax-exempt Colorado corporation and has been granted an exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. CHI sponsors market-based organizations (MBOs) and other facilities in 19 states, including 74 acute-care hospitals, of which 21 are designated as critical access hospitals by the Medicare program, two community health service organizations (CHSOs), two accredited nursing colleges, home health agencies, and 40 other sites including long-term care, assisted living and residential facilities. CHI also has an offshore captive insurance company, First Initiatives Insurance, Limited (FIIL).

The mission of CHI is to nurture the healing ministry of the Church, bringing it new life, energy and viability in the 21st century. CHI is committed to fidelity to the Gospel, with emphasis on human dignity and social justice in the creation of healthier communities. CHI is sponsored by a lay-religious partnership, calling on other Catholic sponsors and systems to unite to ensure the future of Catholic health care.

Basis of Presentation

The consolidated interim financial statements of CHI as of September 30, 2012, and for the three months ended September 30, 2012 and 2011, reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary to fairly state our financial position, results of operations and cash flows for the periods presented. The consolidated interim financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim reporting, and accordingly, do not include all of the disclosures that are required in annual financial statements. As such, these consolidated interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended June 30, 2012. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could vary from the estimates.

Operating results for the three months ended September 30, 2012 and 2011 are not necessarily indicative of the results that may be expected for any future period or for a full fiscal year as revenues, expenses, assets and liabilities can vary during each quarter of the year.

Certain reclassifications were made to the prior fiscal year financial statement presentation to conform to the current fiscal year presentation.

1. Summary of Significant Accounting Policies (continued)

Principles of Consolidation

CHI consolidates all direct affiliates in which it has sole corporate membership or ownership (Direct Affiliates) and all entities in which it has greater than 50% equity interest with commensurate control. All significant intercompany accounts and transactions are eliminated in consolidation.

Fair Value of Financial Instruments

Financial instruments consist primarily of cash and equivalents, patient accounts receivable, investments and assets limited as to use, notes receivable, accounts payable and long-term debt. The carrying amounts reported in the consolidated balance sheets for these items approximate fair value.

Cash and Equivalents

Cash and equivalents include all deposits with banks and investments in interest-bearing securities with maturity dates of 90 days or less from the date of purchase. In addition, cash and equivalents include deposits in short-term funds held by professional managers. The funds generally invest in high-quality, short-term debt securities, including U.S. government securities, securities issued by domestic and foreign banks, such as certificates of deposit and bankers' acceptances, repurchase agreements, asset-backed securities, high-grade commercial paper and corporate short-term obligations.

Net Patient Accounts Receivable, Net Patient Revenues and Provision for Doubtful Accounts

Net patient accounts receivable has been adjusted to the estimated amounts expected to be collected. These estimated amounts are subject to further adjustments upon review by third-party payors.

The provision for bad debts is based upon management's assessment of historical and expected net collections, taking into consideration historical business and economic conditions, trends in health care coverage and other collection indicators. Management routinely assesses the adequacy of the allowances for uncollectible accounts based upon historical write-off experience by payor category. The results of these reviews are used to modify, as necessary, the provision for bad debts and to establish appropriate allowances for uncollectible net patient accounts receivable. After satisfaction of amounts due from insurance, CHI follows established guidelines for placing certain patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by each facility.

1. Summary of Significant Accounting Policies (continued)

Net Patient Accounts Receivable, Net Patient Revenues and Provision for Doubtful Accounts (continued)

CHI records net patient services revenues in the period in which services are performed. CHI has agreements with third-party payors that provide for payments at amounts different from its established rates. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement and negotiated discounts from established rates and per diem payments.

Net patient services revenues are reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations, and excluding estimated amounts considered uncollectible. The differences between the estimated and actual adjustments are recorded as part of net patient services revenues in future periods, as the amounts become known, or as years are no longer subject to such audits, reviews and investigations.

Investments and Assets Limited as to Use

Investments and assets limited as to use include assets set aside by CHI for future long-term purposes, including capital improvements and self-insurance. In addition, assets limited as to use include amounts held by trustees under bond indenture agreements, amounts contributed by donors with stipulated restrictions and amounts held for Mission and Ministry programs.

CHI has designated its investment portfolio as trading. Accordingly, unrealized gains and losses on marketable securities are included within excess of revenues over expenses. In addition, cash flows from the purchases and sales of marketable securities are reported as a component of operating activities in the accompanying consolidated statements of cash flows.

Direct investments in equity securities with readily determinable fair values and all direct investments in debt securities have been measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law.

Investments in limited partnerships and limited liability companies are recorded using the equity method of accounting (which approximates fair value as determined by the net asset values of the related unitized interests) with the related changes in value in earnings reported as investment income in the accompanying consolidated financial statements.

Inventories, primarily consisting of pharmacy drugs and medical and surgical supplies, are stated at lower of cost (first-in, first-out method) or market.

1. Summary of Significant Accounting Policies (continued)

Assets and Liabilities Held for Sale

A long-lived asset or disposal group of assets and liabilities that is expected to be sold within one year is classified as held for sale. For long-lived assets held for sale, an impairment charge is recorded if the carrying amount of the asset exceeds its fair value less costs to sell. Such valuations include estimates of fair values generally based upon discounted cash flows and incremental direct costs to transact a sale.

Property and Equipment

Property and equipment are stated at historical cost or, if donated or impaired, at fair value at the date of receipt or impairment. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. For property and equipment under capital lease, amortization is determined over the shorter period of the lease term or the estimated useful life of the property and equipment. Interest cost incurred during the period of construction of major capital projects is capitalized as a component of the cost of acquiring those assets. Capitalized interest of $5.0 million and $1.6 million was recorded during the three months ended September 30, 2012 and 2011, respectively.

Costs incurred in the development and installation of internal-use software are typically expensed if they are incurred in the preliminary project stage or post-implementation stage, while certain costs are capitalized if incurred during the application development stage. Amounts capitalized are amortized over the useful life of the developed asset following project completion.

Investments in Unconsolidated Organizations

Investments in unconsolidated organizations are accounted for under the cost or equity method of accounting, as appropriate, based on the relative percentage of ownership or degree of influence over that organization. The equity income or loss on these investments is recorded in the consolidated statements of operations as changes in equity of unconsolidated organizations.

Intangible Assets and Goodwill

Intangible assets are amortized over the estimated useful life of each class of amortizable asset using the straight-line method. Amortization expense of $1.4 million and $0.3 million was recorded for the three months ended September 30, 2012 and 2011, respectively.

1. Summary of Significant Accounting Policies (continued)

Intangible Assets and Goodwill (continued)

Goodwill is not amortized but is subject to annual impairment tests as well as more frequent reviews whenever circumstances indicate a possible impairment may exist. Impairment testing of goodwill is done at the MBO level by comparing the fair value of the MBO's net assets against the carrying value of the MBO's net assets, including goodwill. The fair value of net assets is calculated based on quantitative analysis of discounted cash flows. The fair value of goodwill is determined by assigning fair values to assets and liabilities and calculating any remaining fair value as the implied fair value of goodwill.

Notes Receivable and Other Assets

Other assets consist primarily of notes receivable, pledges receivable, deferred compensation assets, deposits and other long-term assets. Notes receivable include balances from the following related entities: Alegent Health and Alegent Health Immanuel Medical Center (collectively, Alegent), the Nebraska joint operating company (JOC) and non-CHI joint operating agreement (JOA) partner, respectively; Bethesda Hospital, Inc. (Bethesda), the non-CHI JOA partner in the Cincinnati, Ohio JOA. All of the notes bear interest at rates commensurate with the CHI blended interest cost and require monthly debt service payments.

A summary of notes receivable and other assets is as follows (in thousands):

	September 30, 2012	June 30, 2012
Notes receivable from related entities:		
Total notes receivable from related entities	**$ 460,220**	$ 465,400
Reinsurance recoverable on unpaid losses and loss adjustment expense	**42,703**	42,703
Deferred compensation assets	**19,785**	18,809
Other long-term assets	**81,320**	78,201
Total notes receivable and other	**$ 604,028**	$ 605,113

Alegent and Bethesda are Designated Affiliates in the CHI credit group under the Capital Obligation Document (COD). As conditions of joining the CHI credit group, the Designated Affiliates have agreed to certain covenants related to corporate existence, insurance coverage, exempt use of bond-financed facilities, maintenance of certain financial ratios and compliance with limitations on the incurrence of additional debt. Based upon management's review of the creditworthiness of the Designated Affiliates and their compliance with the covenants and limitations, no allowances for uncollectible notes receivable were recorded at September 30 and June 30, 2012.

1. Summary of Significant Accounting Policies (continued)

Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity, including endowment funds. Temporarily restricted net assets and earnings on permanently restricted net assets, including earnings on endowment funds, are used in accordance with the donor's wishes primarily to purchase equipment, to provide charity care and to provide other health and educational programs and services.

Unconditional promises to receive cash and other assets are reported at fair value at the date the promise is received. Conditional promises and indications of donors' intentions to give are reported at fair value at the date the conditions are met or the gifts are received. All unrestricted contributions are included in the excess of revenue over expenses as donation revenues. Other gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as donations revenue when restricted for operations or as unrestricted net assets when restricted for property and equipment.

Performance Indicator

The performance indicator is the excess of revenues over expenses, which includes all changes in unrestricted net assets other than changes in the pension liability funded status, net assets released from restrictions for property acquisitions, cumulative effect of changes in accounting principles, discontinued operations, and contributions of property and equipment, and other changes not required to be included within the performance indicator under generally accepted accounting principles.

Operating and Nonoperating Activities

CHI's primary mission is to meet the health care needs in its market areas through a broad range of general and specialized health care services, including inpatient acute care, outpatient services, physician services, long-term care and other health care services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Earnings from certain investments held by FIIL are also classified within operating activities as such earnings help support FIIL operations. Other activities that result in gains or losses peripheral to CHI's primary mission are considered to be nonoperating. Nonoperating activities include: all other investment earnings; gains/losses from bond refinancing; net interest cost and changes in fair value of interest rate swaps; and the nonoperating component of JOA income share adjustments.

1. Summary of Significant Accounting Policies (continued)

Charity Care

As an integral part of its mission, CHI accepts and treats all patients without regard to the ability to pay. Services to patients are classified as charity care in accordance with standards established across all MBOs. Charity care represents services rendered for which partial or no payment is expected, and includes the cost of providing services to persons who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured. The cost of charity care is determined on the basis of an MBO's total cost as a percentage of total charges applied to the charges incurred by patients qualifying for charity care under CHI's policy and is not included in net patient services revenues in the accompanying consolidated statements of operations and changes in net assets.

Meaningful Use of Certified Electronic Health Record Technology Incentive Payments

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in 2011 to certain hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology in ways that demonstrate improved quality and effectiveness of care. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. An initial Medicaid incentive payment is available to providers that adopt, implement or upgrade certified EHR technology. However, in order to receive additional Medicaid incentive payments in subsequent years, providers must demonstrate continued meaningful use of EHR technology.

CHI accounts for meaningful use incentive payments under the gain contingency model. Medicare EHR incentive payments are recognized as revenues when eligible providers demonstrate meaningful use of certified EHR technology and the cost report information for the full cost report year that will determine the full calculation of the incentive payment is available. Medicaid EHR incentive payments are recognized as revenues when an eligible provider demonstrates meaningful use of certified EHR technology. CHI recognized $2.5 million of Medicaid meaningful use revenues in its statements of operations for the three months ended September 30, 2012.

Other Nonpatient Revenues

Other nonpatient revenues include gains and losses on the sales of assets, the operating portion of revenue-sharing income or expense associated with Direct Affiliates that are part of JOAs, cafeteria sales, rental income, retail pharmacy and durable medical equipment sales, auxiliary and gift shop revenues, and revenues from other miscellaneous sources.

1. Summary of Significant Accounting Policies (continued)

Derivative and Hedging Instruments

CHI uses derivative financial instruments (interest rate swaps) in managing its capital costs. These interest rate swaps are recognized at fair value on the consolidated balance sheets. CHI has not designated its interest rate swaps related to CHI's long-term debt as hedges. The net interest cost and change in the fair value of such interest rate swaps is recognized as a component of nonoperating gains (losses) in the accompanying consolidated statements of operations. It is CHI's policy to net the value of collateral on deposit with counterparties against the fair value of its interest rate swaps in other liabilities on the consolidated balance sheets.

Functional Expenses

CHI provides inpatient, outpatient, ambulatory, long-term care and community-based services to individuals within the various geographic areas supported by its facilities. Support services include administration, finance and accounting, information technology, public relations, human resources, legal, mission services and other functions that are supported centrally for all of CHI. Support services expenses as a percent of total operating expenses were approximately 5.7% and 5.2% for the three months ended September 30, 2012 and 2011, respectively.

Restructuring, Impairment and Other Losses

CHI periodically evaluates property, equipment, goodwill and certain other intangible assets to determine whether assets may have been impaired. For the three months ended September 30, 2012 and 2011, no property and equipment impairments were recorded to the extent that the discounted cash flows estimated to be generated by those assets were less than the underlying carrying value.

Included in continuing operations for the three months ended September 30, 2012 and 2011, are total charges of $11.9 million and $0.2 million, respectively, relating to changes in business operations, including reorganization and severance costs. Discontinued operations for the same three months ended September 30, 2012 and 2011, included $1.4 million and $3.8 million, respectively, of charges related to changes in business operations, which are reflected as a component of the consolidated statements of changes in net assets.

1. Summary of Significant Accounting Policies (continued)

Income Taxes

CHI is a tax-exempt Colorado corporation and has been granted an exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. CHI owns certain taxable subsidiaries and engages in certain activities that are unrelated to its exempt purpose and therefore subject to income tax. Management reviews its tax positions annually and has determined that there are no material uncertain tax positions that require recognition in the accompanying consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could vary from the estimates.

Adoption of New Accounting Standards

Effective on July 1, 2012, CHI adopted the provisions of Accounting Standards Update (ASU) No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Entities*. ASU 2011-07 requires health care entities to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient services revenues from an operating expense to a deduction from patient services revenues (net of contractual allowances and discounts). All periods presented have been reclassified to conform with the provisions of ASU 2011-07.

2. Acquisitions and Divestitures

Acquisitions

KentuckyOne Health – Effective on January 1, 2012, CHI acquired an additional 58% interest in Jewish Hospital St. Mary's HealthCare, Inc. System (JHSMH), which resulted in JHSMH being fully consolidated into CHI's results of operations. For the three months ended September 30, 2012, JHSMH contributed \$221.9 million of operating revenues and \$11.7 million of deficit of revenues over expenses to the CHI consolidated results of operations. Had CHI owned JHSMH at July 1, 2011, JHSMH would have contributed \$228.8 million of operating revenues and \$28.1 million of deficit of revenues over expenses in 2011 on a pro forma basis.

Nebraska Heart Hospital and Nebraska Heart Institute – Effective on August 1, 2011, CHI acquired Nebraska Heart Hospital and Nebraska Heart Institute for a cash purchase price of \$131.1 million. The acquisition allowed CHI to expand cardiac, thoracic and vascular care across the state of Nebraska.

Divestitures

Discontinued Operations – CHI has committed to a plan to sell the MBO's in Denville, NJ, Towson, MD, and Pierre, SD. In accordance with Accounting Standards Codification (ASC) 205-20, *Discontinued Operations* and *ASC 360-10, Assets Held for Sale,* the operations associated with these MBO's have been reported as discontinued operations and are included in the consolidated statements of changes in net assets. Assets held for sale consist primarily of net patient accounts receivable, net property and other long-term assets. Liabilities held for sale consisted of accounts payable, and accrued compensation and benefits. Total operating revenues and deficit of revenues over expenses included in the results of discontinued operations are summarized below (in thousands):

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011
Total operating revenues	**\$ 161,772**	\$ 165,941
Total operating expenses	**164,001**	182,856
Restructuring and other losses	**1,432**	3,802
Nonoperating gains (losses)	**4,919**	(9,589)
Excess (deficit) of revenues over expenses	**\$ 1,258**	\$ (30,306)

The consolidated statements of cash flows include the use of \$25.9 million and \$27.2 million of operating, investing and financing activities related to discontinued operations for the three months ended September 30, 2012 and 2011, respectively.

3. Net Patient Services Revenues

Net patient services revenues are derived from services provided to patients who are either directly responsible for payment or are covered by various insurance or managed care programs. CHI receives payments from the federal government on behalf of patients covered by the Medicare program, from state governments for Medicaid and other state-sponsored programs, from certain private insurance companies and managed care programs and from patients themselves. A summary of payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic and other factors. Certain CHI facilities have been designated as critical access hospitals and, accordingly, are reimbursed their cost of providing services to Medicare beneficiaries. Professional services rendered by physicians are paid based on the Medicare allowable fee schedule.

Medicaid – Inpatient services rendered to Medicaid program beneficiaries are primarily paid under the traditional Medicaid plan at prospectively determined rates per discharge. Certain outpatient services are reimbursed based on a cost reimbursement methodology, fee schedules or discounts from established charges.

Other – CHI has also entered into payment agreements with certain managed care and commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to CHI under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

CHI's Medicare, Medicaid and other payor utilization percentages, based upon net patient services revenues before provision for doubtful accounts, are summarized as follows:

	Three Months Ended September 30,	
	2012	2011
Medicare	**30%**	30%
Medicaid	**7**	7
Managed care	**35**	38
Self-pay	**10**	11
Commercial and other	**18**	14
	100%	100%

3. Net Patient Services Revenues (continued)

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Estimated settlements related to Medicare and Medicaid of $57.5 million and $56.6 million at September 30, and June 30, 2012, respectively, are included in third-party liabilities. Net patient services revenues from continuing operations increased by $7.0 million and $6.2 million for the three months ended September 30 2012 and 2011, respectively, due to favorable changes in estimates related to prior-year settlements.

4. Investments and Assets Limited as to Use

CHI's investments and assets limited to use are reported in the accompanying consolidated balance sheets as presented in the following table (in thousands):

	September 30, 2012	June 30, 2012
Cash and equivalents	**$ 126,693**	$ 155,418
CHI Investment Program	**4,965,194**	4,827,922
Marketable equity securities	**343,196**	315,064
Marketable fixed-income securities	**497,211**	477,440
Hedge funds and other investments	**150,745**	162,190
	6,083,039	5,938,034
Less current portion	**(4,310)**	(1,901)
	$ 6,078,729	$ 5,936,133

Net unrealized gains at September 30 and June 30, 2012 were $317.4 million and $144.0 million, respectively.

CHI attempts to reduce its market risk by diversifying its investment portfolio using cash equivalents, marketable equity securities, fixed-income securities and alternative investments. Most of the U.S. Treasury, money market funds and corporate debt obligations as well as exchange-traded marketable securities held by CHI and the CHI Investment Program (the Program) have an actively traded market. However, CHI also invests in commercial paper, mortgage-backed or other asset-backed securities, alternative investments (such as hedge funds, private equity investments, real estate funds, funds of funds, etc.), collateralized debt obligations, municipal securities and other investments that have potential complexities in valuation based upon the current conditions in the credit markets. For some of these instruments, evidence supporting the determination of fair value may not come from trading in active primary or secondary markets. Because these investments may not be readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been

4. Investments and Assets Limited as to Use (continued)

used had an active market for such investments existed. Such differences could be material. However, management reviews the CHI investment portfolio on a regular basis and seeks guidance from its professional portfolio managers related to U.S. and global market conditions to determine the fair value of its investments. CHI believes the carrying amount of these financial instruments in the consolidated financial statements is a reasonable estimate of fair value. Additionally, CHI assesses the risk of impairment related to securities held in its investment portfolio on a regular basis and noted no impairment during the three month period ended September 30, 2012, and during the year ended June 30, 2012.

Substantially all CHI long-term investments are held in the Program. The Program is structured under a Limited Partnership Agreement with CHI as managing general partner and numerous limited partners, most sponsored by CHI. The partnership provides a vehicle whereby virtually all entities associated with CHI, as well as certain other unrelated entities, can optimize investment returns while managing investment risk. Entities participating in the Program that are not consolidated in the accompanying financial statements have the ability to direct their invested amounts and liquidate and/or withdraw their interest without penalty as soon as practicable based on market conditions but within 180 days of notification. The Limited Partnership Agreement permits a majority vote of the noncontrolled limited partners to terminate the partnership. Accordingly, CHI recognizes only the portion of Program assets attributable to CHI and its sponsored affiliates. Program assets attributable to CHI and its direct affiliates represented 86% of total Program assets at September 30, and June 30, 2012.

The Program asset allocations were as follows:

	September 30, 2012	June 30, 2012
Marketable equity securities	**45%**	44%
Marketable fixed-income securities	**35**	35
Alternative investments	**18**	19
Cash and equivalents	**2**	2
	100%	100%

The CHI Investment Committee (the Investment Committee) of the Board of Stewardship Trustees is responsible for determining asset allocations among fixed-income, equity and alternative investments. At least annually, the Investment Committee reviews targeted allocations and, if necessary, makes adjustments to targeted asset allocations. Given the diversity

4. Investments and Assets Limited as to Use (continued)

of the underlying securities in which the Program invests, management does not believe there is a significant concentration of credit risk.

Investment income (loss) is comprised of the following (in thousands):

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011
Dividend and interest income	$ 30,267	$ 27,169
Net realized gains	34,605	283
Net unrealized gains (losses)	173,196	(441,594)
Total investment income (loss) from continuing operations	$ 238,069	$ (414,142)
Included in other nonpatient revenue	$ 33,243	$ 7,459
Included in nonoperating gains (losses)	204,826	(421,600)
Total investment income (loss) from continuing operations	$ 238,069	$ (414,142)
Total investment income (loss) from discontinued operations	4,919	(9,590)
Total investment income (loss)	$ 242,988	$ (423,732)

Direct expenses of the Program were less than 0.4% of total assets during the prior fiscal year and are estimated to remain below this level in the current fiscal year. Fees paid to the alternative investment managers are not included in the total expense calculation as they are not a direct expense of the Program.

5. Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial Accounting Standards Board ASC 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

Level 1 – Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets.

5. Fair Value of Assets and Liabilities (continued)

Level 2 – Valuation is based upon quoted prices for similar assets and liabilities in active markets or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial asset or liability.

Level 3 – Valuation is based upon other unobservable inputs that are significant to the fair value measurement.

Certain of CHI's alternative investments are made through limited liability companies (LLCs) and limited liability partnerships (LLPs). These LLCs and LLPs provide CHI with a proportionate share of the investment gains (losses). CHI accounts for its ownership in the LLCs and LLPs under the equity method. CHI also accounts for its ownership in the Partnership under the equity method. As such, these investments are excluded from the scope of ASC 820.

Financial assets and liabilities measured at fair value on a recurring basis were determined using the following inputs at September 30, and June 30, 2012 (in thousands):

	September 30, 2012 Fair Value Measurements at Reporting Date Using			
		(Level 1)	(Level 2)	(Level 3)
	Fair Value as of September 30	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets				
Assets limited as to use:				
Cash and short-term investments	$ 126,693	$ 66,242	$ 60,451	$ –
Marketable equity securities	343,196	343,196	–	–
Marketable fixed-income securities	497,211	85,023	412,188	–
Other investments	2,383	–	–	2,383
Deferred compensation assets:				
Cash and short-term investments	11,546	11,546	–	–
	$ 981,029	$ 506,007	$ 472,639	$ 2,383
Liabilities				
Interest rate swaps	$ 235,660	$ –	$ 235,660	$ –
Deferred compensation liability	11,546	11,546	–	–
	$ 247,206	$ 11,546	$ 235,660	$ –

5. Fair Value of Assets and Liabilities (continued)

	June 30, 2012 Fair Value Measurements at Reporting Date Using			
		(Level 1)	(Level 2)	(Level 3)
	Fair Value as of June 30	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets				
Assets limited as to use:				
Cash and short-term investments	$ 155,418	$ 108,448	$ 46,970	$ –
Marketable equity securities	315,064	315,064	–	–
Marketable fixed-income securities	477,440	900	476,540	–
Other investments	1,953	–	–	1,953
Deferred compensation assets:				
Cash and short-term investments	10,852	10,852	–	–
	$ 960,727	$ 435,264	$ 523,510	$ 1,953
Liabilities				
Interest rate swaps	$ 238,549	$ –	$ 238,549	$ –
Deferred compensation liability	10,852	10,852	–	–
	$ 249,401	$ 10,852	$ 238,549	$ –

The fair values of the securities included in Level 1 were determined through quoted market prices. Level 1 securities include money market funds, mutual funds and marketable debt and equity securities. The fair values of Level 2 securities were determined through evaluated bid prices based on recent trading activity and other relevant information, including market interest rate curves and referenced credit spreads; estimated prepayment rates, where applicable, are used for valuation purposes and are provided by third-party services where quoted market values are not available. Level 2 investments include corporate fixed–income securities, government bonds, mortgage and asset-backed securities, and interest rate swaps. The fair values of Level 3 securities are determined primarily through information obtained from the relevant counterparties for such investments. Information on which these securities' fair values are based is generally not readily available in the market.

6. Debt Obligations

The following is a summary of debt obligations (in thousands):

	Interest Rates at September 30, 2012	Balances at September 30, 2012	Balances at June 30, 2012
Variable-rate Bonds:			
Series 1997B, maturing through 2022	0.29%	**$ 18,900**	$ 18,900
Series 2000B, maturing through 2028	0.19%	**25,700**	27,300
Series 2002B, maturing 2032	0.19%	**103,300**	103,300
Series 2004B, maturing through 2044	0.16–0.21%	**180,700**	180,700
Series 2004C, maturing through 2044	0.18-0.19%	**163,300**	163,300
Series 2008A, maturing 2036	0.16%	**120,260**	120,260
Series 2008C, maturing 2041	0.15%	**50,000**	50,000
Series 2011B, maturing 2046	0.18%	**158,155**	158,155
Series 2011C, maturing 2046	0.15%	**125,000**	125,000
Fixed-rate Bonds:			
Series 2002A, maturing 2017	5.50%	**4,140**	4,140
Series 2004A, maturing through 2034	4.75–5.00%	**146,605**	146,605
Series 2006A, maturing through 2041	4.00–5.00%	**384,135**	384,135
Series 2006C, maturing through 2041	3.85–5.10%	**250,000**	250,000
Series 2008C, maturing through 2041	4.00–5.00%	**105,000**	105,000
Series 2008D, maturing through 2038	5.00–6.38%	**473,950**	473,950
Series 2009A, maturing 2039	3.00–5.50%	**753,620**	772,110
Series 2009B, maturing 2039	5.00%	**260,995**	260,995
Series 2011A, maturing 2041	2.00–5.25%	**526,090**	526,090
Series 2012A, maturing 2035	3.00–5.00%	**271,260**	271,260
Commercial Paper		**475,625**	475,625
Unamortized debt premium		**56,709**	58,832
Unamortized debt discount		**(9,441)**	(9,801)
Total CHI debt issued under the COD		**4,644,003**	4,665,856
Capital leases and other debt		**76,331**	77,391
		4,720,334	4,743,247
Less: Amounts classified as current			
Variable-rate debt with self-liquidity		**(321,455)**	(321,455)
Commercial paper and current portion of debt		**(643,599)**	(643,083)
Long-term debt		**$ 3,755,280**	$ 3,778,709

CHI issues the majority of its debt under the COD and is the sole obligor. Bondholder security resides both in the unsecured promise by CHI to pay its obligations and in its control of its Direct and Designated Affiliates. Covenants include a minimum CHI debt service coverage ratio and certain limitations on secured debt. The Direct Affiliates of CHI, defined as Participants under the COD, have agreed to certain covenants related to corporate existence, maintenance of insurance and exempt use of bond-financed facilities.

6. Debt Obligations (continued)

CHI issues the majority of its debt under the COD and is the sole obligor. Bondholder security resides both in the unsecured promise by CHI to pay its obligations and in its control of its Direct and Designated Affiliates. Covenants include a minimum CHI debt service coverage ratio and certain limitations on secured debt. The Direct Affiliates of CHI, defined as Participants under the COD, have agreed to certain covenants related to corporate existence, maintenance of insurance and exempt use of bond-financed facilities.

CHI has two types of external liquidity facilities: those that are dedicated to specific series of variable-rate demand bonds (VRDBs) and those that are not dedicated to a particular series of VRDBs but may be used to support CHI's obligations to fund tenders of VRDBs and pay the maturing principal of commercial paper. Liquidity facilities that are dedicated to specific series of bonds were $623.9 million and $625.5 million at September 30 and June 30, 2012, respectively, of which $9.4 million is classified as current debt at both September 30 and June 30, 2012. The remaining $614.5 million and $616.1 million at September 30 and June 30, 2012, respectively, are reported as long term debt due to the repayment terms on any associated drawings extending beyond the subsequent fiscal year under the terms of the specific agreements.

Liquidity facilities not dedicated for specific series of VRDBs but used to support CHI's obligations to fund tenders and to pay maturing principal of commercial paper was $435.0 million at both September 30 and June 30, 2012. At both September 30 and June 30, 2012, $475.6 million of commercial paper was classified as current due to maturities of less than one year and $321.5 million of VRDBs and Windows were classified as current due to the holder's ability to put such VRDBs and Windows back to CHI without liquidity facilities dedicated to these bonds.

At September 30, 2012, CHI had a $45.0 million credit facility with Wells Fargo Bank. Letters of credit totaling $43.2 million have been issued for the benefit of third parties, principally in support of the self-insurance programs administered by FIIL. At September 30 and June 30, 2012, no amounts were outstanding under this credit facility.

CHI is a party to seven floating-to-fixed interest rate swap agreements with notional amounts totaling $931.8 million at both September 30 and June 30, 2012. Generally, it is CHI policy that all counterparties have an AA rating or better. The swap agreements require CHI to provide collateral if CHI's liability, determined on a mark-to-market basis, exceeds a specified threshold that varies based upon the rating on the corporation's long-term indebtedness. These fixed-payor swap agreements convert CHI's variable-rate debt to fixed-rate. The seven swaps have varying maturity dates ranging from May 2025 to December 2036. The fair value of the swaps is estimated based on the present value sum of anticipated future net cash settlements until the swaps' maturities. At September 30 and June 30, 2012, the fair value of the swap liability was $235.7 million and $238.5 million, respectively. Cash collateral balances of $128.4 million and $140.7 million at September 30 and June 30, 2012, respectively, are netted against the fair value

6. Debt Obligations (continued)

of the swaps, and the net amount is reflected in other liabilities. The change in the fair value of these agreements was a gain of $2.9 million and a loss of $107.1 million for the three months ended September 30, 2012 and 2011, respectively.

7. Retirement Plans

CHI and its direct affiliates maintain noncontributory, defined benefit retirement plans (Plans) covering substantially all employees. Benefits in the Plans are based on compensation, retirement age and years of service. Vesting occurs over a five-year period. Substantially all of the Plans are qualified as church plans and are exempt from certain provisions of both the Employee Retirement Income Security Act and Pension Benefit Guaranty Corporation premiums and coverage. Funding requirements are determined through consultation with independent actuaries.

CHI recognizes the funded status (that is, the difference between the fair value of plan assets and the projected benefit obligations) of its Plans in the consolidated balance sheets, with a corresponding adjustment to net assets. Actuarial gains and losses that arise and are not recognized as net periodic pension cost in the same periods are recognized as a component of net assets.

Estimated amounts for the components of net periodic pension expense are summarized in the table below. Amounts will be adjusted at year-end to reflect actual results, based on the final annual actuarial reports (in thousands):

	Three Months Ended September 30,	
	2012	**2011**
Components of net periodic pension expense:		
Service cost	**$ 52,411**	$ 40,923
Interest cost	**36,591**	37,436
Expected return on the Plans' assets	**(51,465)**	(48,261)
Amortization of prior service benefit	**47**	47
Actuarial losses	**23,115**	9,594
Settlement charge	**115**	-
	$ 60,814	$ 39,739

8. Concentrations of Credit Risk

CHI grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. CHI's exposure to credit risk on patient accounts receivable is limited by the geographical diversity of its MBOs. The mix of receivables from patients and third-party payors approximated the following:

	September 30, 2012	June 30, 2012
Medicare	**26%**	26%
Medicaid	**10**	11
Managed care	**31**	32
Self-pay	**8**	6
Commercial and other	**25**	25
	100%	100%

CHI maintains long-term investments with various financial institutions and investment management firms through its investment program, and its policy is designed to limit exposure to any one institution or investment. Management does not believe there are significant concentrations of credit risk at September 30 and June 30, 2012.

9. Commitments and Contingencies

Litigation

During the normal course of business, CHI may become involved in litigation. Management assesses the probable outcome of unresolved litigation and records estimated settlements. After consultation with legal counsel, management believes that any such matters will be resolved without material adverse impact to the consolidated financial position or results of operations of CHI.

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Management believes CHI is in compliance with all applicable laws and regulations of the Medicare and Medicaid programs. Compliance with such laws and regulations is complex and can be subject to future governmental interpretation as well as significant regulatory action, including fines, penalties and exclusion from the Medicare and Medicaid programs. Certain CHI entities have been contacted by governmental agencies regarding alleged violations of Medicare practices for certain services. In the opinion of management after consultation with legal counsel, the ultimate outcome of these matters will not have a material adverse effect on CHI's consolidated financial position.

10. Subsequent Events

Taxable Debt Issuance

Effective on October 31, 2012, CHI issued $1.5 billion of par value long-term, fixed-rate, taxable bonds. Proceeds will be used to finance a wide array of strategic initiatives, including virtual technologies, physician integration and partnerships, and alliances in key areas across the country.

The large bond issue resulted in a decline in CHI's credit ratings from AA to AA- from all three rating agencies (Fitch Ratings, Standard & Poors and Moody's Investors Service), with a stable outlook designation.

Alegent Creighton Health

Effective on November 1, 2012, CHI became the sole member and sponsor of Alegent Creighton Health (Alegent), acquiring the remaining sponsorship previously held by Immanuel since 1996. The operations of Alegent include Immanuel Medical Center and its affiliates in the Omaha area, and the operations of Creighton University Medical Center acquired by Alegent in September 2012. As part of the acquisition, CHI and Immanuel also signed a joint development agreement to establish a strategic collaboration to address the housing, health care and human services needs of seniors and their families throughout Nebraska and Iowa.

Soundpath Health

Effective on October 29, 2012, CHI acquired a majority interest in Soundpath Health, a provider-owned health care plan based in Federal Way, WA, that offers Medicare Advantage plans. The acquisition is pending approval by the Washington State Office of the Insurance Commissioner.